MIDDLE MARKET Growth

Healthcare Report 2023

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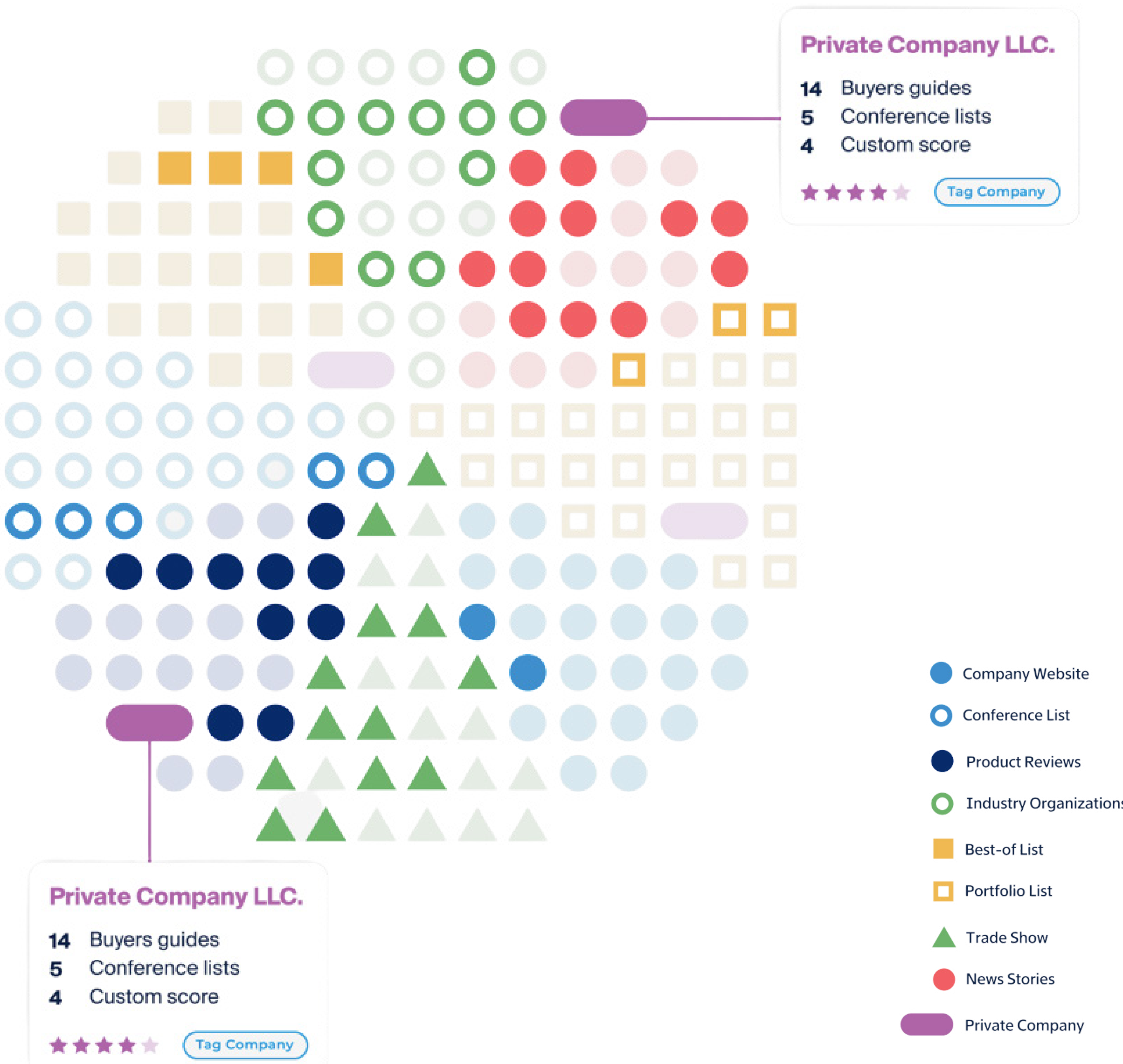

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Delivering Healthcare Insights for Thematic Investors

The first in a new series of digital reports dives into sector-specific M&A opportunities

Thematic investing has come into vogue in a big way, as buyers seek to differentiate themselves with specialized expertise and to build inroads with companies not yet on the market.

The Association for Corporate Growth has tailored its programming accordingly through industry-focused events. Conferences like the recent Agtech Investor Symposium presented by ACG Raleigh Durham create venues for like-minded dealmakers to learn about trends within their target industry and explore investment opportunities.

ACG's media offerings are similarly expanding to offer more industry-focused content, most recently through the launch of a new series of sector-focused digital reports.

This first report, which spotlights healthcare, highlights trends shaping M&A opportunities within the sector. It also includes explorations of healthcare niches that look especially promising for investors, ranging from cardiology practice management to clinical research organizations to revenue cycle management solutions.

To produce these pages, our writers drew from recent and notable healthcare transactions; spoke to healthcare-focused private equity investors, investment bankers and other experts; and analyzed data about M&A activity and dynamics shaping the U.S. healthcare market. Sourcescrub, a deal sourcing platform for M&A teams and the exclusive sponsor of this report, provided data for various healthcare niches, revealing the number of independent companies in the market relative to those with investor backing.

The resulting report isn't meant to be comprehensive but rather a distillation of some of the most interesting areas of healthcare for middle-market dealmakers today.

Readers will no doubt find value in the other sources of healthcare content and connections offered throughout ACG. They include live events, like ACG New York's Healthcare Conference in February and DealMAX in Las Vegas at the end of April, where attendees can schedule meetings based around their industry interests using the conference's meeting scheduling tool. Registration is now open at dealmax.org.

Other healthcare sector resources are ACG's membership database, which allows users to search for fellow members by industry focus, and an ever-growing library of healthcare-related articles available on middlemarketgrowth.org.

Beyond healthcare, ACG's media group will be publishing more digital reports in the coming year that explore deals, trends and emerging opportunities in other sectors of interest to ACG members. Look out for those in 2024. //

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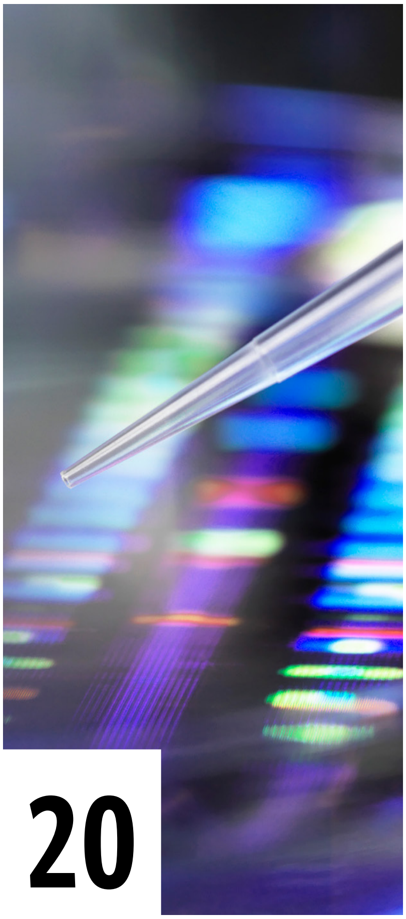

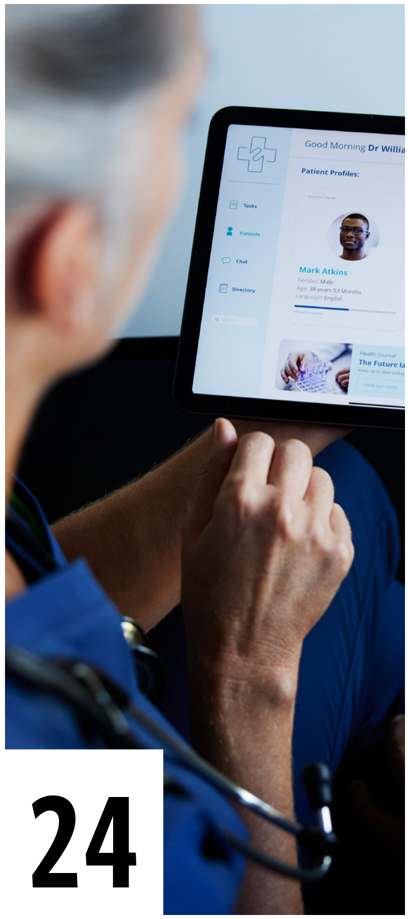

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Navigating the Turbulent Waters of Healthcare Mergers and Acquisitions

While labor shortages and rising bankruptcies are weighing on the healthcare sector, investors still see M&A opportunities in select niches

BY CYNTHIA KINCAID

This past year was another challenging one for hospitals and health systems across the U.S. Staff shortages, relentless inflation, falling reimbursements, the continuing interruption of COVID-19 and the escalating costs of essential supplies continue to plague the health-care industry. However, there are "green shoots" of hope amid these headwinds: Patient volumes are returning, staffing and contract labor costs are normalizing, and the slower-than-expected M&A environment is starting to rebound. These positive shifts are breathing new life into the healthcare sector.

The industry's resilience in the face of unprecedented adversity has been partially sustained by the federal government's allocation of more than $700 billion in spending related to the COVID pandemic, according to the Committee for a Responsible Federal Budget. While this fiscal lifeline helped to shore up the beleaguered healthcare sector, more will need to be done. Many financial experts expect mergers and acquisitions to play a pivotal role in reshaping the battered healthcare landscape. Healthcare organizations, biotechnology companies and hospitals are well-positioned for increased M&A activity in 2024 and 2025.

"The larger companies have stronger balance sheets and have been able to weather the storm quite well," says Ross Nelson, principal and national healthcare strategy leader at KPMG. "There are several smaller companies that need capital. If they are publicly traded, they don't have a constructive enough stock price to raise equity. So, we are expecting a lot of M&A activity to happen in the middle market."

A Changing M&A Landscape

According to an analysis from KPMG, the number of healthcare deals continued to decline in the second quarter of 2023, the lowest level in three years, but things are starting to tick up. *Becker's Hospital Review* has reported that the 245 M&A deals completed by Q2 of this year was only 7% lower than in Q2 2022 but still 41% lower than Q2 2021.

"We are seeing a lot more acquisitions and divestitures for entities that have multiple lines of business and are thinking about the portfolio areas where they want to either double down or exit," says Nelson.

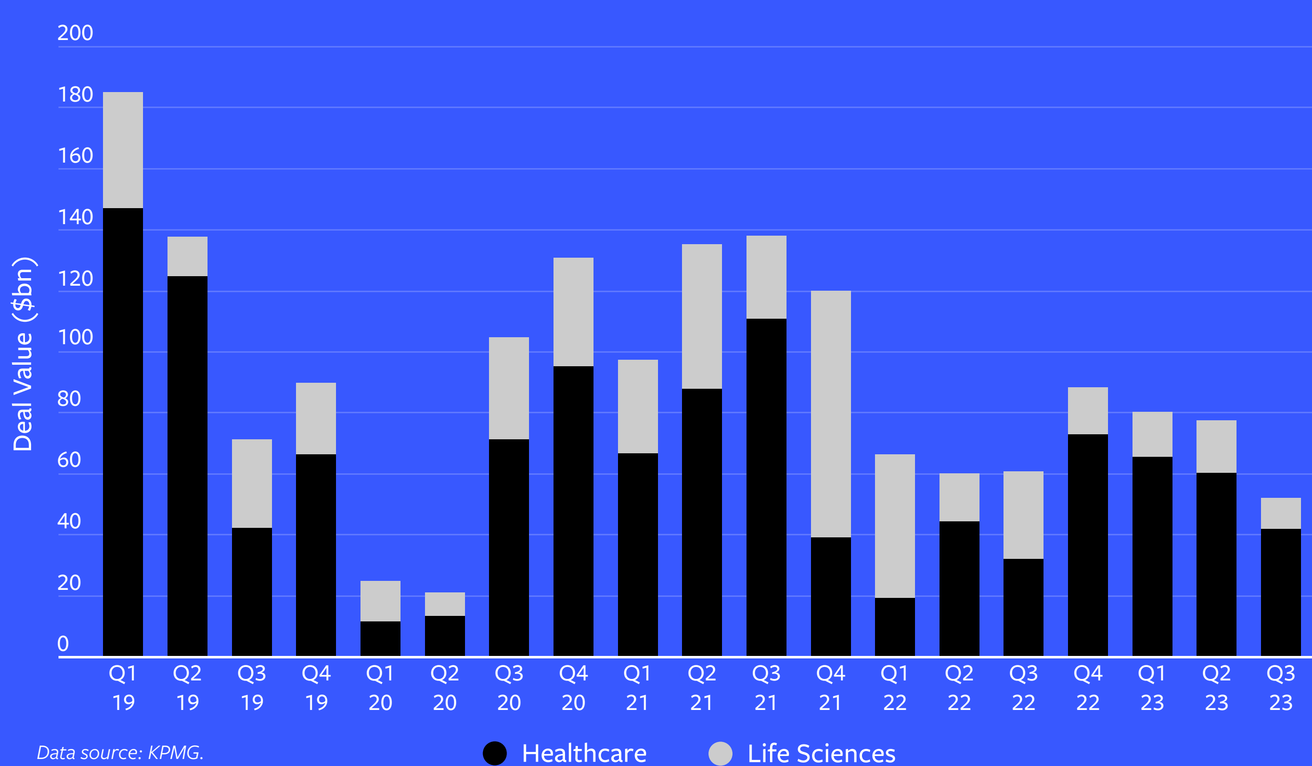
A coalition of 31 life sciences, pharma and biotech organizations announced a partnership on Oct. 4 to advocate for M&A in these sectors. Their coalition was formed in response to the Federal Trade Commission's recent efforts to crack down on mergers and acquisitions on antitrust grounds.

High-quality, growth-focused healthcare businesses are attracting robust interest from both financial and strategic buyers, according to Cheairs Porter, Harris Williams' managing director of healthcare and life sciences. Competitive valuations, multiple bids and aggressive closing behavior are becoming increasingly common for top-tier companies in the healthcare sector, he says.

"Compared to the first half of this year, it feels like there is a little more momentum in deal flow in the second half of this year," says Karen Winterhof, partner at FFL Partners. "We think deal flow is going to pick up in the next six to 12 months. There's only so long you can be on the sidelines."

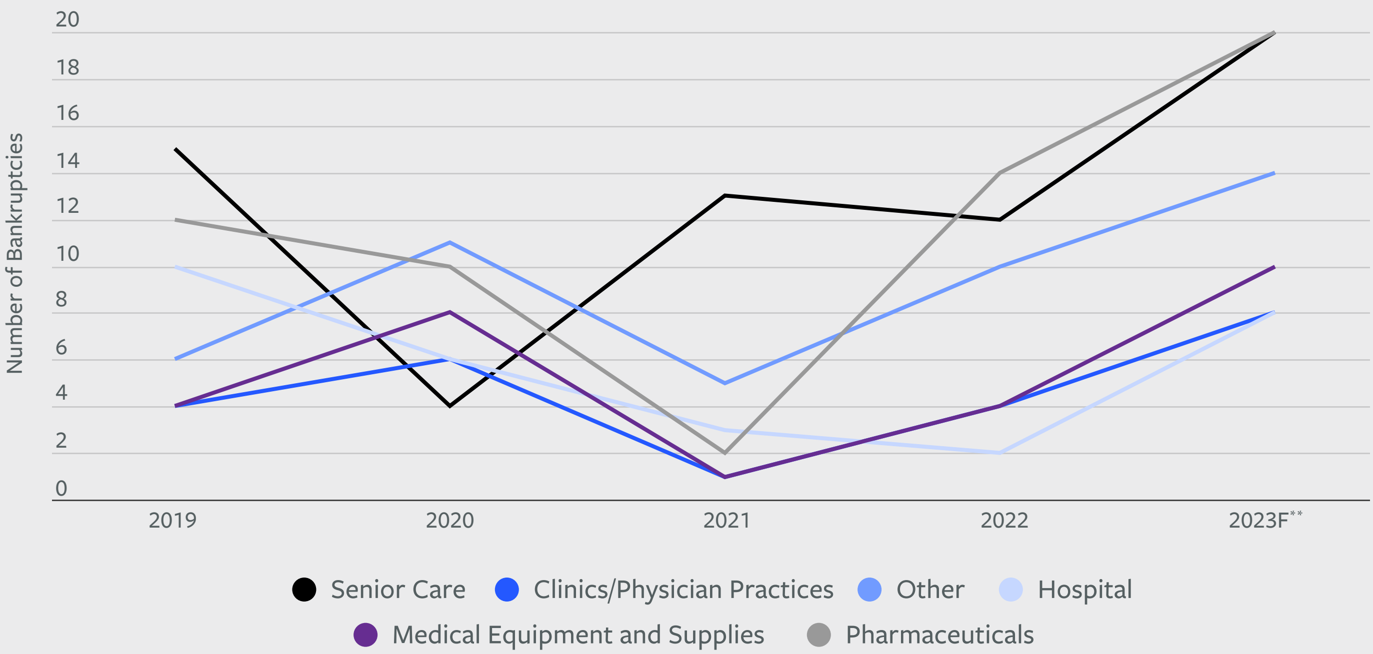
There also has been notable variability in deal volume from one subsector to another, according to Porter. There is specific interest and activity in provider subsegments, such as physical therapy, vision, dental and orthopedics. With strong consumer demand for healthcare services, M&A in the provider segment is expected to gain momentum in 2024.

U.S. Healthcare & Life Sciences M&A By Quarter



Data source: KPMG.

Large* Healthcare Bankruptcies by Subsector: 2019 through 2023F**



Data sources: Gibbins Advisors' July 2023 Healthcare Restructuring: Trends and Outlook Report; PACER; and bankruptcydata.com.

**A large bankruptcy is one defined as involving a company with more than $10 million in liabilities.*
***Forecasted by annualizing filings January through June 2023.*

M&A buyers also are diversifying their interest beyond providers into healthcare information technology, medical products, product services and pharmaceutical services. "We've spent more time around pharmaceutical services," says Winterhof. "That's been a more attractive space for us, and we completed an investment recently partnering with a few founders."

Urgent care, once a darling for private equity owners, has cooled a bit over the past decade because of oversaturation in some metropolitan areas. Still, urgent care clinics remain popular in some areas because of the shortage of primary care physicians. More than 100 million Americans don't have easy access to a primary care physician, according to the National Association of Community Health Centers. In response, a variety of alternatives have cropped up, such as One Medical (owned by Amazon), and retail clinics in stores like CVS, Walmart and Target, and even in some neighborhood grocery stores.

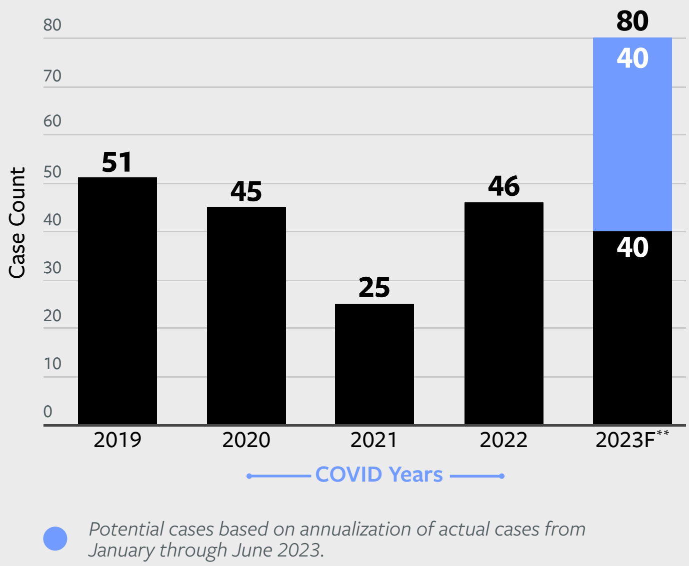
"Payers want you to go to urgent care because they're quick and efficient and therefore should be cost-effective," says Greg Belinfanti, senior managing director at private equity firm One Equity Partners, which invests in healthcare, among other industries. "I think big questions will be around the consumerization of healthcare and whether we can maintain or even improve quality while reducing cost of care. Time will tell."

Winterhof finds these alternative care choices to be a positive. "I think those businesses push the whole industry to make a more convenient patient experience," she says. "That means more people will have access to good healthcare."

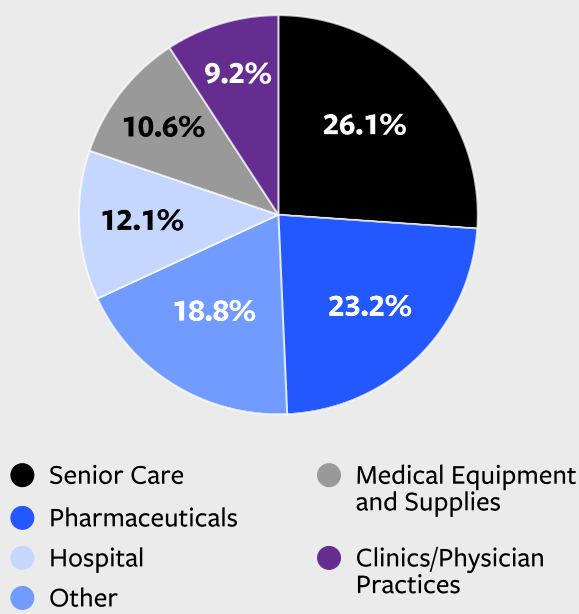
Labor Shortages: A Looming Crisis

While some healthcare subsectors are in demand, labor shortages continue to weigh heavily on the industry. According to industry market analytics firm Mercer, by 2025, the U.S. is projected to have a shortage of 446,000 home health aides, 95,000 nursing assistants, 98,700 medical and lab technicians and 29,000 nurse practitioners. Adding to the crisis, an estimated 334,000 healthcare providers left their jobs in 2021, including 117,000 physicians, 53,000 nurse practitioners and 22,700 physician assistants, according to a report by Definitive Healthcare, an industry-focused software provider.

Large* Healthcare Bankruptcy Filings (2019 to 2023F**)



Share of Large* Healthcare Bankruptcies by Subsector: 2019 through Q2 2023



Data sources: Gibbins Advisors' July 2023 Healthcare Restructuring: Trends and Outlook Report; PACER; and bankruptcydata.com.

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***Forecasted by annualizing filings January through June 2023.*

A study conducted by the National Council of State Boards of Nursing and the National Forum of State Nursing Workforce Centers estimates that more than 800,000 nurses intend to leave the workforce by 2027. This equates to one-fifth of the current 4.5 million nurses in the workforce today.

"The U.S. is suffering from a significant healthcare worker shortage, and early data shows that this is going to have near-term and long-term effects on both patient care and hospital and physician performance," the study says.

Not surprisingly, wage inflation has directly contributed to the soaring costs that hospitals, health systems and other healthcare organizations are facing. These costs have taken a tremendous toll on expenses and revenue.

"In most other businesses, when costs increase, one of the first things you do is try to implement price increases," says Belinfanti. "But with most healthcare services, you don't have that luxury because price is typically set by the government as payer, or managed care plans that are indexed to government prices. Thus, healthcare companies frequently have to wait a year or two to lobby for reimbursement rate increases."

He adds that healthcare organizations are struggling with determining what a normalized financial picture looks like, especially around staffing, where traveling contract nurses were commanding rates during the pandemic as high as $180 to $200 an hour. Those rates, he says, have now fallen back closer to $100 to $110 an hour. "What does the 'new normal' look like, and how does one price assets that have seen such large fluctuations in price and financial performance? This has created some stagnation in the M&A market," Belinfanti says.

We think deal flow is going to pick up in the next six to 12 months. There's only so long you can be on the sidelines.

KAREN WINTERHOF | *Partner, FFL Partners*

Healthcare Bankruptcies: An Industry in Flux

Some of the clouds in pockets of healthcare have pushed companies into distress. Healthcare bankruptcy filings in 2023 are trending three times the level seen in 2021, according to Gibbins Advisors, a healthcare advisory firm. Senior care and pharmaceutical subsectors continue to make up approximately half of the total healthcare bankruptcy filings.

"There was a level of distress in the healthcare sector before COVID, caused by macro trends, such as population demographics, how care is changing with technology, and care models in the outpatient and community-based environment," says Clare Moylan, principal at Gibbins Advisors. "With COVID-related government funding, the hospitals in particular were able to work through challenges with a healthier balance sheet."

Now that the government funding is gone, Moylan says the systemic issues facing health systems are still present, with costs rising and margins squeezed. "Bankruptcies are tracking to be higher this year than pre-COVID," she says.

Senior care has been heavily impacted by financial challenges over the past few years, representing 26.1% of large healthcare bankruptcies from 2019 through Q2 2023, according to Gibbins Advisors. "We are seeing a lot of pressure by states to reduce the number of licensed nursing home beds and facilities," says Ronald Winters, principal at Gibbins Advisors. "We are going to have to see if that is a long-sighted approach."

Alternatively, home-based care appears to be relatively immune to current bankruptcy trends and continues to attract investor interest. In 2022, 37 of the 628 healthcare private equity transactions were home health and hospice deals, as reported by *Home Health Care News*.

A Shifting Paradigm: Value-Based Care and Technology

Seismic shifts are taking place in healthcare, with an increasing emphasis on value-based care, which ties what providers earn for their services to the results delivered to patients. These results can include quality of care, more effective and efficient delivery of care, and cost savings to both the patient and the healthcare organization. Investment in companies focused on quality over volume has surged, with growth exceeding 4x between 2019 and 2021, according to a McKinsey & Co. analysis. McKinsey projects that if the value-based care market continues to grow at its current rate, it could eventually reach a valuation of $1 trillion.

Technology will emerge as a crucial component in financially transforming the healthcare sector and attracting M&A interest. A May 2023 study conducted by Eagle Telemedicine revealed 94.6% of hospitals across the country now use telemedicine. Healthcare organizations also are increasingly turning to digital technology and artificial intelligence to analyze data, improve revenue cycle management and reduce readmissions.

Gibbins Advisors' Winters points out that change comes with a caveat: "It will mean disruption to the old way in favor of the new way, and providers that don't transform with the market will be left behind," he says. "Healthcare will continue to transform, but some organizations won't survive because they won't successfully evolve to the new model."

Perhaps the mergers and acquisitions of the future will help usher in a new paradigm in healthcare. Time will tell. //

CYNTHIA KINCAID is a journalist with extensive experience writing about the financial and healthcare industries.

Sourcescrub

Healthcare Deal Sourcing:

How to Evaluate GenAI Impact on Value

GenAI is a transformative technology that will upend industries. We know generically that it will impact "knowledge workers", but such a broad piece of wisdom isn't very helpful for understanding its potential effects on specific industries or companies – especially in markets as fragmented and complex as healthcare.

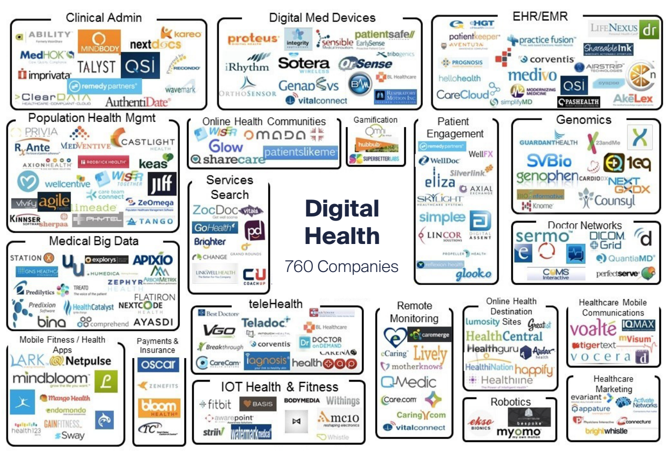
Understanding how various healthcare sectors, sub-sectors, and even specific businesses will be impacted by this game-changing advancement is critical for dealmakers to effectively determine which opportunities are ripe for disruption, and which may be headed for extinction.

The WINS framework, introduced in a recent Harvard Business Review article titled "Where Should Your Company Start with GenAI" (published on 9/11/23), can be applied to objectively measure the impact and potential for applying GenAI in healthcare.

Healthcare: Massive and Fragmented

Health-related products and services now account for over [18% of total US GDP](), and post-COVID concerns, the aging Baby Boomer generation, increased mental health awareness, and recent scientific and technological advancements continue to make healthcare one of the fastest growing industries in the world. Conditions are driving unprecedented innovation and potential.

But healthcare is massive and highly fragmented, with at least 6 core sectors and sub-sectors that include everything from hospitals, digital health, and dental services to alternative medicine, medical research, and healthcare consulting. The digital health sub-sector alone features more than 760 companies that are categorized even further by telemedicine, genomics, remote monitoring, and more.



Venture Scanner

This market fragmentation enables dealmakers to create competitive advantage through specialization and proprietary sourcing. But it also makes it extremely difficult to know precisely where to place bets.

WINS Framework

Nearly [80% of US business executives] rank generative AI as the number one emerging technology over the next 3-5 years. Like every sector, healthcare will be transformed by GenAI, but the impact will be uneven with the potential for dramatic improvements in business performance and patient outcomes, or displacement as new AI-driven solutions obviate traditional businesses.

WINS is a helpful framework for evaluating where GenAI will have the biggest impact. Although developed to identify the easiest ways for companies to get started with GenAI, the WINS framework can also be used to objectively understand the areas where GenAI is likely to cause the most disruption.

WINS stands for 'Words, Images, Numbers and Sounds' — the things GenAI is most capable of automating. WINS work refers to the places where tasks, functions, or even an entire company or industry rely on the manipulation and interpretation of Words, Images, Numbers, and Sounds.

GenAI has the potential to supercharge WINS work. It can generate copy, computer code, images, narration, music, and videos as well as ingest and summarize, critique, improve, and reformat almost any kind of document or analysis. Every WINS task or subprocess can be evaluated for potential leverage with GenAI.

Two New Sources of Value in Healthcare

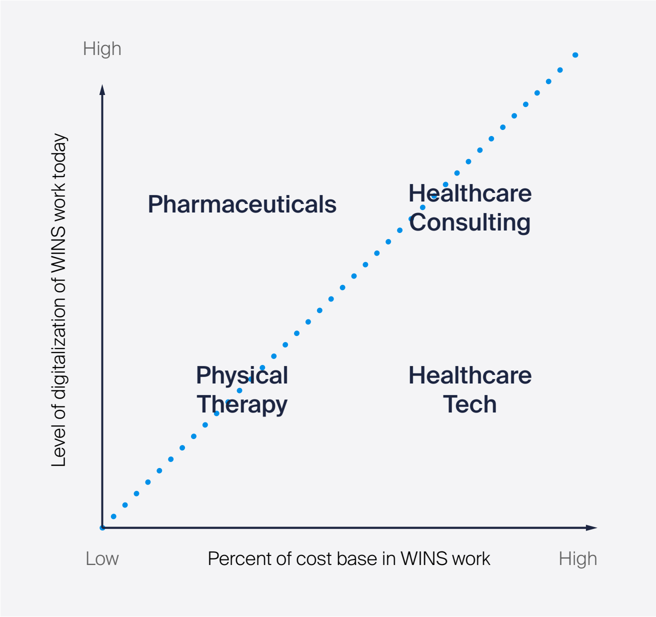
By adapting models like the WINS framework to understand the full potential of GenAI, Private Equity can begin to look at healthcare deals differently. In the past, Private Equity firms would develop an investment thesis built on ways target companies could maximize EBITDA margin. Typically, this means improving economics by streamlining sales, finance, and operations along with ways to drive scale or market expansion.

In a recent webinar on the past, present, and future of AI, John Shaw, AI entrepreneur and CEO of Value Add Machine, discussed how AI can help maximize EBITDA. In every deal, he suggested you should now ask, "What could an AI model do to reduce resource consumption?" He pointed to AWS QuickSight, an AI-driven business intelligence (BI) service that analyzes and visualizes data from multiple sources, as a way for a company's data analysts to focus on more impactful tasks than simply generating reports. Or, perhaps with a code-generating AI model, engineering costs could be reduced or reallocated.

Investors can now also look beyond efficiency for ways GenAI can create brand new sources of product or service value. For example, previously undervalued assets like data from failed clinical trials could now be the reason to pursue a deal. In pharmaceuticals, AI-assisted research may be able to help create new drugs based on what might have been considered dead data.

This potential allows dealmakers to consider new questions:

- What companies have WINS-based products or services that are vulnerable to new GenAI solutions?
- Who is producing AI-based solutions that can replace WINS work?
- How much of a company's expenses are connected to WINS work that can be eliminated?
- How can those resources be deployed to create new product or service value?



Applying WINS in PE Context

The WINS framework can be applied at a high level to broadly understand the relative impact of GenAI on an industry or sub-industry. To understand the potential impact of GenAI, score and plot industries on two dimensions: How much cost is connected to WINS work? And how digitized are the WINS inputs today?

You can conclude that an industry like Healthcare Consulting, with a large number of WINS-related roles and high degree of digitization, has large potential for performance improvements as roles are enhanced or replaced by GenAI capabilities. Physical therapy, with much fewer WINS-related roles and a lower level of digitization, has far less potential for dramatic GenAI-related performance improvements.

WINS can also be used to quantify the potential impact of GenAI on a specific set of companies to score them and rank value potential.

By looking at employee headcount by occupation, you can create a scoring model based on a company's aggregate exposure to WINS-related impact. One approach would be to use occupation data from a source like LinkedIn which has headcount estimates by role and skills.

There is also public data from studies like Oxford University’s research on the future of work that looked at the susceptibility of specific jobs to digitization. Their research categorizes and scores 702 occupations according to their potential for automation.

Measuring Potential is Key to Success

A recent experiment to quantify the productivity gains of GenAI was conducted at Boston Consulting Group. They looked at 18 different tasks designed to mimic real work performed at a top-tier consulting company. The consultants who utilized ChatGPT-4 significantly outperformed those who didn't across every category and method of measuring productivity. On an average, consultants using AI completed 12.2% more tasks, accomplished tasks 25.1% faster, and generated 40% higher quality results.

GenAI is here, and it promises to both create and destroy company value. Dealmakers who are able to objectively predict and measure the impact are going to outperform, particularly in complex and highly competitive industries like healthcare.

Healthcare Services Sector Gains Strength

Deal activity looks likely to rise amid an overall M&A rebound; cardiology and home health and hospice are two categories to watch

BY KATIE MALONEY

The U.S. healthcare services subsector continues draw investor interest thanks to an aging population, rising obesity, a shift toward outpatient care and increased adoption of value-based care models.

They're among the drivers that have spurred continued M&A activity on the part of private equity investors and strategic acquirers in categories like primary care, oncology services, behavioral health, cardiology, and home health and hospice, despite a relatively slow year for M&A overall.

PwC's [2023 midyear outlook] noted that megadeals valued above $5 billion accounted for over half of the announced healthcare services deal value in the 12 months ending May 15—a figure consistent with the prior two years. The report showed relatively steady enterprise value to EBITDA multiples over the past year but a marked drop from 2021. As of mid-May, healthcare services companies traded at 13.6x on average, compared with 13.7x at the end of 2022 and 15.9x at the end of 2021.

There were 263 healthcare services transactions announced in the second quarter of this year, including 132 by strategic buyers and 131 by private equity firms and PE-backed companies, according to a [report] from healthcare-focused investment bank Provident Healthcare Partners, citing PitchBook data.

Two areas within healthcare services worth watching are cardiology, and home healthcare and hospice, both of which reflect tailwinds benefiting the overall sector, while offering distinct advantages to investors.

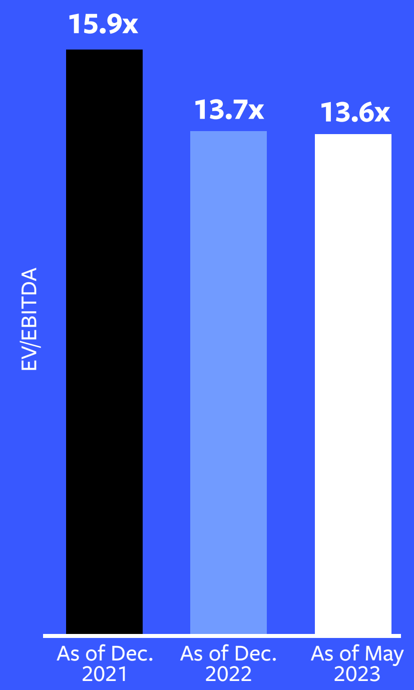
Follow the Heart

An aging population and rising obesity rates are contributing to private equity's interest in cardiology, as is an uptick in outpatient procedures approved by Medicare.

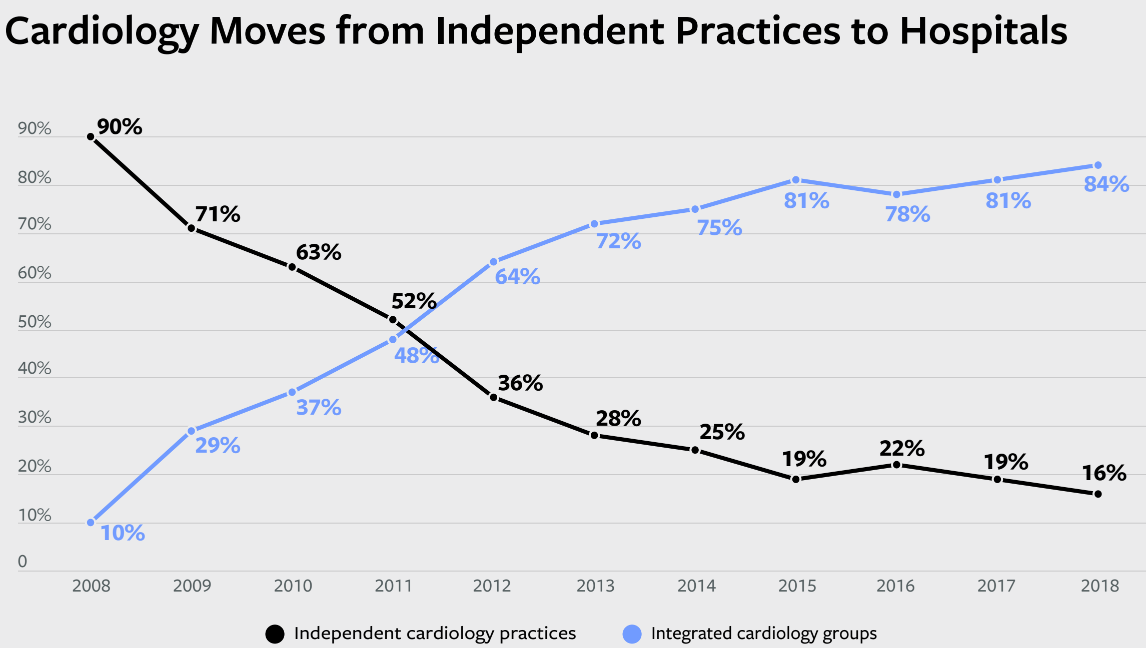
Those dynamics appeal to private equity firms, whose involvement in cardiology began in earnest within the last two years, according to Eric Major, a managing director at Provident Healthcare Partners. "I think investors feel that there's a shift occurring within cardiology to the outpatient setting," he says. "Historically, it's been a hospital-based service."

Also drawing investor interest are new ancillary services offered by cardiology groups, such as remote patient monitoring, chronic care management, advanced imaging services such as PET/CT scans, weight loss management and nutrition counseling. "There are just a lot of opportunities for these cardiology practices, given that they're serving effectively as the primary care provider for those patients who have chronic heart issues," Major says.

Average Enterprise Value to EBITDA Multiples for Health Services Deals



Data source: PwC's Health Services - US Deals 2023 Midyear Outlook.



Data source: American College of Cardiology/MedAxiom CVTransforum. October 2019.

Webster Equity Partners is among the active investors in cardiology, via its platform Cardiovascular Associates of America (CVAUSA). The company's CEO, Dr. Tim Attebery, formed CVAUSA with Webster Equity in 2021 to bring together cardiovascular group practices while enabling specialists to retain autonomy and ownership. CVAUSA has acquired 17 practices as of September, and Attebery expects that number to reach 24 or 25 by the end of this year.

Other active acquirers include Ares-backed US Heart & Vascular, which formed in 2021 and has since established partnerships with practice affiliates in Arizona, Texas and Kansas.

In February, Lee Equity Partners announced a new platform, Cardiovascular Logistics, to build and support a network of U.S. cardiovascular practices. The platform announced its partnership with First Coast Cardiovascular Institute, a network of 38 providers in the southeastern U.S., in April.

Major estimates there are around 12 PE-backed cardiology platforms today in total.

Although private equity's involvement is recent, the cardiology space isn't new to consolidation. Attebery points to the passage of the federal Deficit Reduction Act in 2005 as a watershed event for the industry.

The law, which cut reimbursement rates for independent cardiologists starting in 2006, prompted many to sell their practices to hospitals. "We went from a very low percentage of hospital-employed cardiologists prior to 2006—maybe less than 10% [employed by hospitals], to within five years after that, it's 80%," says Attebery, who estimates there are now about 750 independent cardiology practices across the U.S.

Ultimately, the Deficit Reduction Act failed to save money, Attebery notes. "Hospitals owning and employing cardiologists has resulted in two bad things: increased cost and very unhappy cardiologists," a group that he calls "entrepreneurial by heart."

As their contracts with hospitals expire, some cardiologists may be interested in reestablishing their own practices with help from investors. "[The PE firm] can invest into their practices, into the equipment and all the cap ex that they need to move back into private practice, and then hopefully maintain relationships with the health system as much as they can after that transition," Major says.

Home Healthcare & Hospice: A Fragmented Market

2,636
U.S. Mid-Market*
Companies

228
Sponsor-Backed
Mid-Market
Companies

1,217
Independent Mid-Market Companies

175
Average
Headcount

Mid-market is defined as 100-2,000 employees

Data source: Sourcescrub.

Home Health & Hospice

As with cardiology practices, demand from an aging population and the promise of lower care costs have spurred steady M&A in the home health and hospice arena.

A Q2 report on healthcare trends from KPMG estimated that the post-acute care sector accounted for 16% of healthcare M&A volume in the quarter. Notable transactions include the $3.3 billion acquisition of home health provider Amedisys by Optum, a UnitedHealth subsidiary, in June.

The home health and hospice category is highly fragmented, creating continued room for consolidation. Data from Sourcescrub, a deal sourcing platform for M&A teams, suggests there are 2,636 mid-market home health and hospice companies in the U.S. with between 100-2,000 employees. Of those businesses, 228 are backed by private equity sponsors, while 1,217 are independently operated.

The home healthcare and hospice sector is attracting some of the highest valuation multiples in healthcare, according to a recent report from Kroll. Multiples based on the last 12 months′ EBITDA averaged 14.5x, compared with 11.5x for the healthcare industry overall.

Dan Harknett, a partner at private equity firm Ridgemont Equity Partners, says hospice has been an attractive segment of healthcare for his firm because of the United States' aging population, patients' preference to be at home and the lower costs associated with delivering end-of-life care at home compared with a hospital setting. "To quantify that, it's roughly 90% less expensive per day," Harknett says. Two years ago, Ridgemont invested in Agape Care Group, which provides hospice services in the Southeast.

The hospice sector will benefit from a reimbursement rate increase of 3.1% for the 2024 fiscal year, announced by the Centers for Medicare & Medicaid Services in July. The adjustment follows similar increases in recent years. At the same time, industry-watchers say the category will face increased scrutiny from regulators, adding time and compliance expenses for hospice operators.

Meanwhile, home healthcare businesses will face a modest decrease in Medicare reimbursement rates next year. Industry-watchers and prospective buyers are cautiously waiting to see if other cuts will follow in 2025.

Even with those headwinds, merger and acquisition activity is expected to continue within home health and hospice.

"I think there's continued M&A momentum in the category," Harknett says. //

KATIE MALONEY is ACG's content director.

Investors Bet on High-Growth Pharma Companies

While deal count is down across the board, a select crop of successful pharma businesses continues to trade for high multiples

BY ANASTASIA DONDE

Any given sector is under pressure from market headwinds this year, and deal volume is down across the board. Experts in the pharmaceutical sector note that their specialty is no exception but say there is still robust activity across select pockets of pharma and pharma services, where some companies are trading for EBITDA multiples as high as 20x.

Sector bankers say the businesses selling at these valuations are usually able to show strong growth potential through organic channels, add-on acquisitions, geographic expansion and diversification of services.

Industry experts say some clinical research organizations (CROs), contract development and manufacturing organizations (CDMOs), clinical trial site companies, and research and data companies are garnering high prices. “Activity across all these sectors is slower in 2023 than 2022, but deals are still trading at attractive multiples,” says Brian Doyle, managing director and head of healthcare services at investment bank William Blair.

High Fliers

Clinical research companies Worldwide Clinical Trials and Ergomed, and data provider CorEvitas are among the recent pharma companies that have sold for a premium.

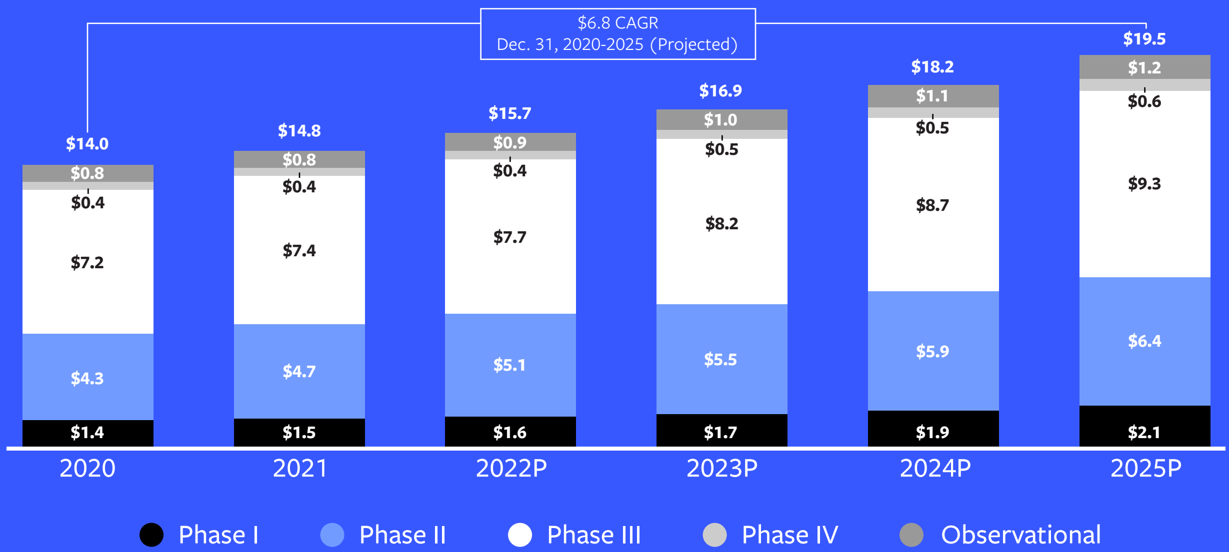
Kohlberg & Co. announced it was buying a majority stake in Worldwide Clinical Trials, a North Carolina-based CRO, in August. The deal, which is expected to close in the fourth quarter, valued the company at $2 billion, or an 18x multiple on EBITDA, according to 9fin.

Worldwide partners with biotechnology and pharmaceutical companies to create customized solutions that advance new medications. The company’s capabilities span bioanalytical laboratory services, phase I-IV clinical trials, and post-approval and real-world evidence studies. With 3,200 employees across 60 countries, Worldwide focuses on cardiovascular, metabolic, neuroscience, oncology and rare diseases.

In September, European private equity firm Permira agreed to buy U.K. biopharmaceutical company Ergomed in a take-private deal valued at $886.4 million—a 28% premium to Ergomed’s closing trading price.

Total U.S. Clinical Trial Site Market

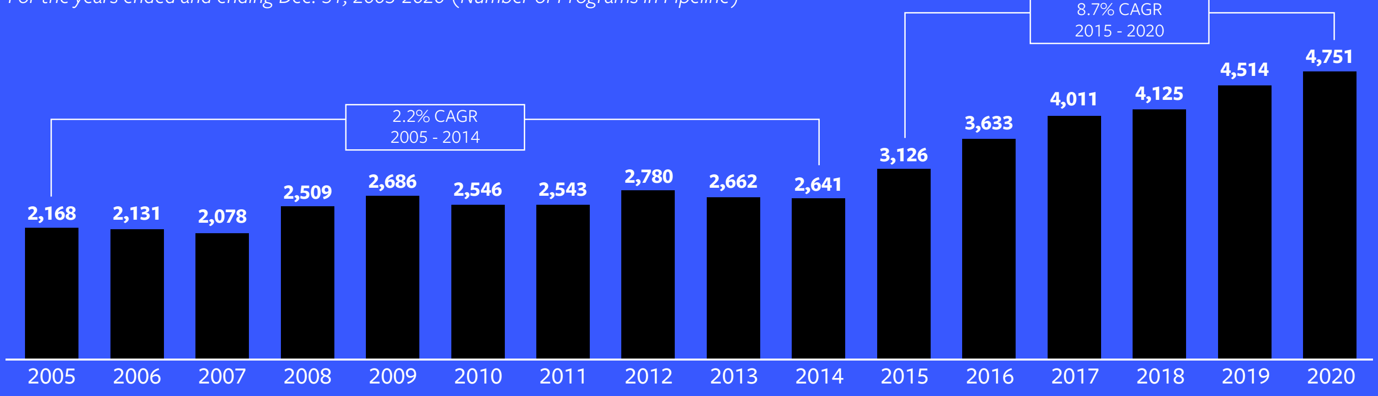
For the years ended and ending Dec. 31, 2020-2025 (Projected)
($ in billions)



Data sources: Harris Williams’ Q1 2023 Clinical Trial Sites Overview; and HealthAdvances.

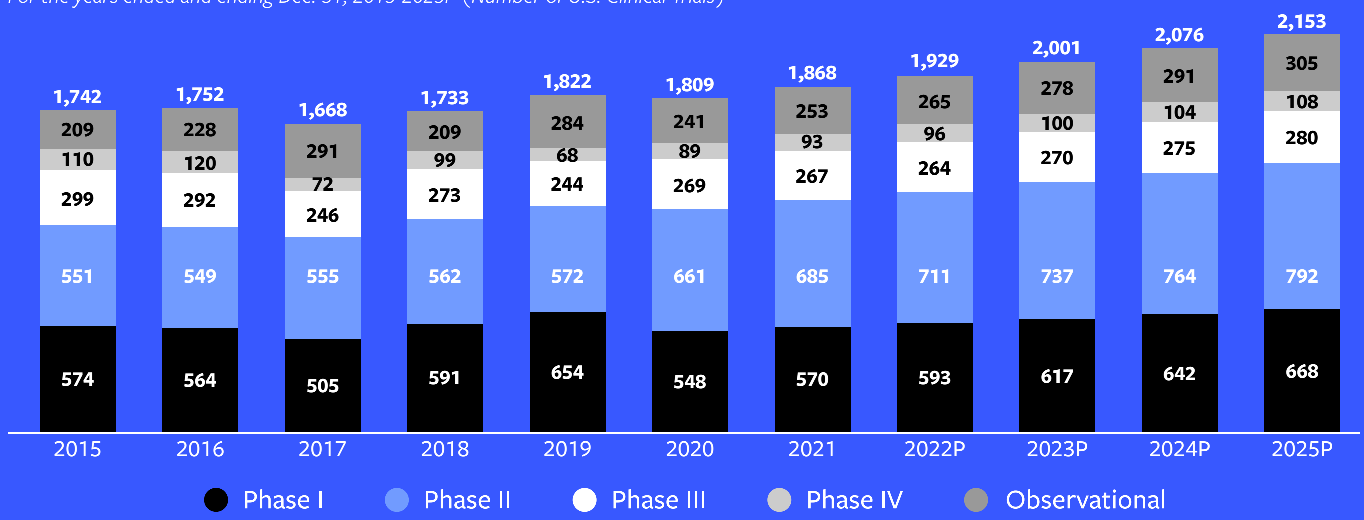
Pre-Clinical Drug Pipeline

For the years ended and ending Dec. 31, 2005-2020 (Number of Programs in Pipeline)



Total U.S. Clinical Trials

For the years ended and ending Dec. 31, 2015-2025P (Number of U.S. Clinical Trials)



Data sources: Harris Williams' Q1 2023 Clinical Trial Sites Overview; and HealthAdvances.

"There haven't been as many deals in CROs, but activity continues for businesses that are seen as leaders or differentiators," says Doyle.

According to Sourcescrub data, there are 523 middle-market CROs in the U.S., 282 of which are independent. The average headcount of middle-market CROs is about 181.

CROs with advisory boards that have access to pharma companies and drug development before studies are even announced have a competitive advantage in the market, says James Castro, senior managing director at B. Riley Securities. "The history of CROs has been very fragmented in terms of being able to provide a very specific service to the pharma community. Now, we're seeing integration across all functions," he adds. This fits the private equity playbook well. "Private equity firms are really good at saying: There's no reason why we can't offer these complementary services to the exact same customer, and that will further entrench us to steer the business our way."

In a notable transaction in the pharma research niche, CorEvitas fetched $912.5 million in its sale to Thermo Fisher Scientific. The company, which was

Early detection of cancer is going to continue to fuel a huge spend, which means drug developers will need more support from the biotech and outsourced pharma communities.

JAMES CASTRO | *Senior Managing Director, B. Riley Securities*

formerly backed by Audax Private Equity, is poised to generate $110 million in revenue for 2023, an announcement from Thermo Fisher said. The Waltham, Massachusetts-based data intelligence company provides biopharmaceutical companies with data and clinical insights that demonstrate the value of their products to clinicians, patients, payers and regulators.

William Blair's Doyle, who advised on the deal, says the high valuation underscored the need for continued evaluation of pharmaceutical products as they are launched and vetted, and as their usage and effectiveness is monitored on an ongoing basis.

What's Next for Clinical Trial Site Companies

When it comes to testing drugs, treatment or therapy, companies that oversee clinical trial site management have been popular investment targets for private equity sponsors in recent years. Private equity firms that have bought or built platforms in the space have been tacking on countless add-ons and consolidating the highly fragmented sector, which comprises many companies that could benefit from an expansion in services, geography and diversity of study participants across demographics.

London-based private equity firm GHO Capital acquired one of the larger companies in the space, Velocity Clinical Research, from NaviMed Capital in 2021 for $500 million. The company's EBITDA was around $30 million-$35 million at the time, though it projected $50 million in forward EBITDA for 2021, according to PE Hub.

Both Velocity and Webster Equity Partners-backed CenExel, some of the largest clinical trial site companies in the U.S., have bought a slew of other sites in recent years and significantly broadened their geographic footprint.

B. Riley's Castro says interest among private equity sponsors continues to be strong amid growing demand for clinical trial site management services. "There has been an enormous amount of continued spending in central nervous system studies, as well as anything related to oncology," he says. "Even early detection of cancer is going to continue to fuel a huge spend, which means drug developers will need more support from the biotech and outsourced pharma communities."

Here too, companies have been trading for high multiples—15x or more, according to Castro—but private equity firms still have a viable path to successful exits, given the growth of some of these businesses. "Private equity investors believe there is potential to generate greater than 20% IRR on those transactions," Castro says, adding that sponsors can achieve healthy exits by diversifying services and geographies, and continuing to buy single-site companies.

Recent deals in the space included VSS Capital Partners' growth capital investment in Eximia Research Network, and New Harbor Capital's investment in Monroe Biomedical Research. Eximia is a multi-therapeutic clinical trial research company that serves pharmaceutical companies, biotech companies and CROs. Monroe is a clinical trial site business that recruits patient populations for complex trials across a variety of therapeutic areas.

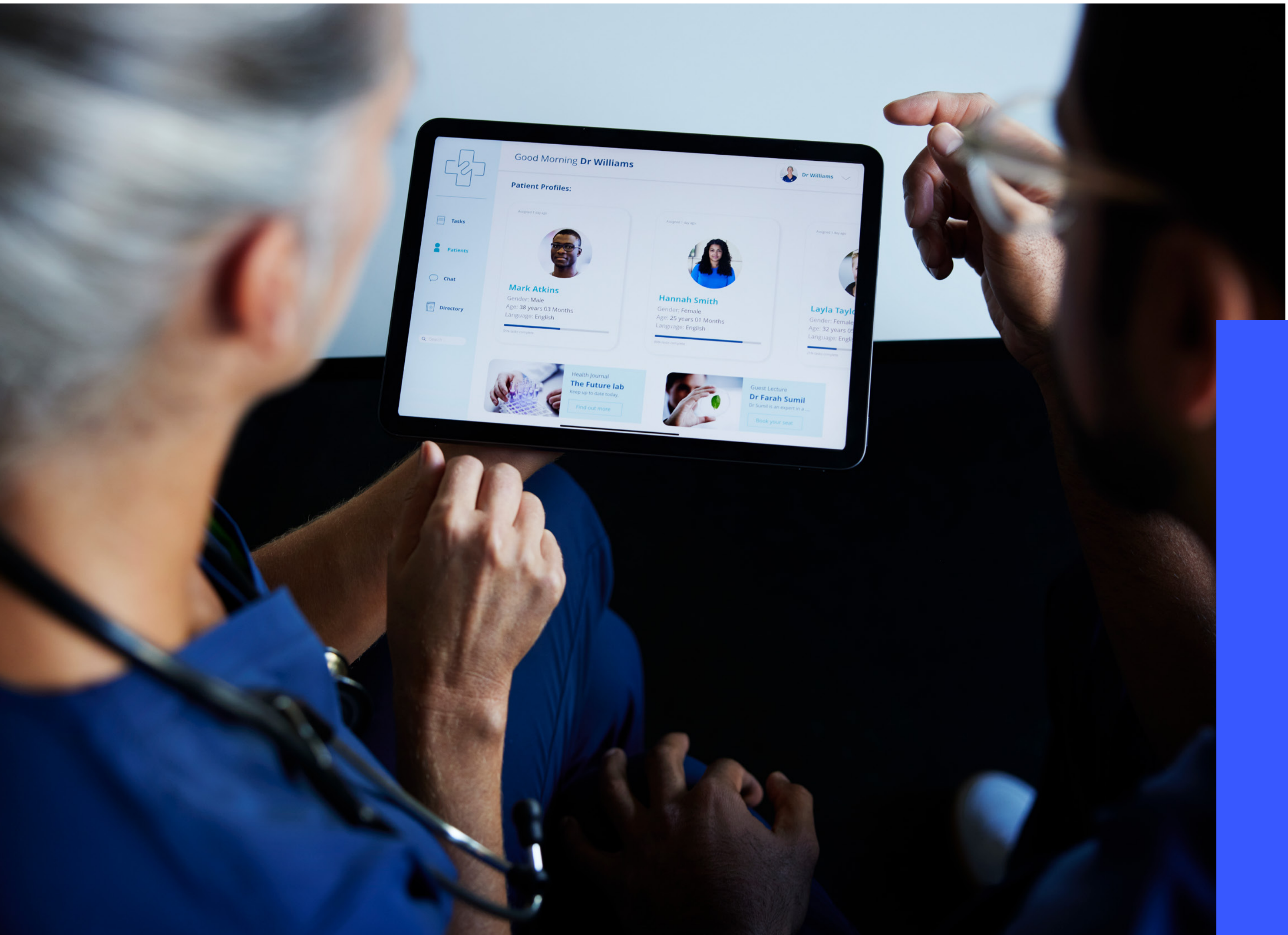
Castro thinks there is a lot more room for growth, and companies can continue to trade to other private equity sponsors as they grow or merge among themselves. "I've been involved in a lot of discussions where some of these larger entities are talking to each other about potentially merging," he says. //

ANASTASIA DONDE is *Middle Market Growth*'s senior editor.

Healthcare Evolves to Embrace Next-Gen Tech

As healthcare IT solutions grow more sophisticated, M&A dealmakers say rising adoption is inevitable

BY CAROLYN VALLEJO



While healthcare has proven a resilient investment target amid an M&A slowdown, IT designed for healthcare settings has not always been in acquirers' crosshairs.

Although complex regulatory barriers and a low risk appetite for digital transformation have slowed digitization among healthcare providers, practice groups are gradually unlocking the benefits of healthcare IT (HCIT) in both the front and back office. As adoption grows, so does the attraction of healthcare IT investments to middle-market dealmakers.

"Healthcare IT brings M&A investors the potential for highly recurring revenue, good visibility and sticky client bases—regardless of subsector," says James Clark, managing director in the Healthcare & Life Sciences Group of investment bank Harris Williams. "While we saw a slowdown in 2022, as we did in many sectors, there are many great healthcare IT businesses looking to drive growth through M&A and new platform investments in 2024."

Middle-market HCIT M&A volume is strong compared to pre-pandemic levels. A Capstone Partners report noted that 74 transactions were completed or announced in Q1 2023, representing an increase from Q1 2019 and 2018 of 23.3% and 54.2%, respectively. Nearly one-third of healthcare IT M&A deals in Q1 2023 were private equity add-ons, while 63.5% were led by private and public strategic acquirers, the report noted.

Thanks to continued technological innovation, new HCIT solutions are enabling workflow automation, unlocking value in healthcare data, increasing productivity and helping to improve patient outcomes. The result is a diversifying range of potential investment targets for both PE sponsors and strategics.

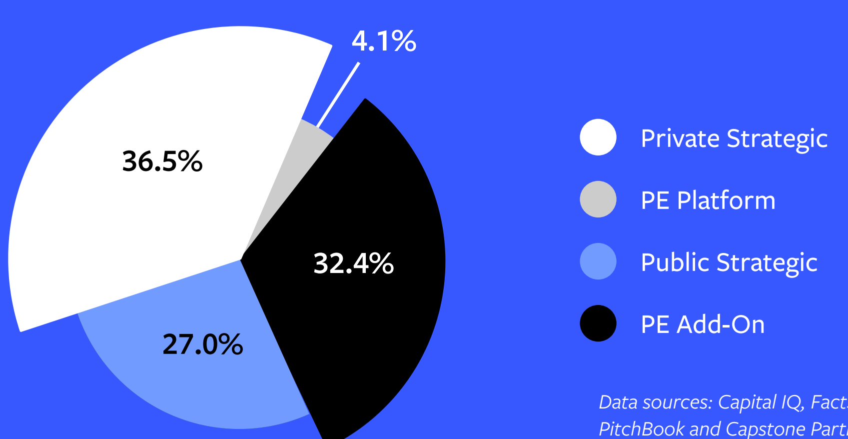
From Back Office to Patient Care

Among the most popular healthcare IT investment targets are revenue cycle management (RCM) and electronic records management (ERM) technologies. Experts say the market for these solutions is fragmented: Data from M&A deal sourcing platform Sourcescrub finds 852 RCM businesses and 709 ERM companies.

The state of healthcare today has created powerful use cases for these solutions. "Due to the sector's complexity and inefficiency, healthcare businesses spend billions of dollars collecting revenue," notes Clark. "Factor in labor challenges related to medical claims coding and processing, and the strong value prop of outsourced RCM software and services becomes clear."

Ben Herman, a partner at private equity

Q1 '23 HCIT M&A Transaction Type



Data sources: Capital IQ, FactSet, PitchBook and Capstone Partners.

Healthcare IT: By the Numbers

967

Mid-Market* HCIT Companies

212

Sponsor-Backed Mid-Market HCIT Companies

853

Mid-Market Revenue Cycle Management Companies

709

Mid-Market Electronic Records Management Companies

**Mid-market is defined as 100-2,000 employees*

Data source: Sourcescrub.

firm LightBay Capital, says RCM and ERM solutions can be particularly useful to a business after a merger, allowing for data consolidation on a single system across a newly combined healthcare network. “Having everyone on the same technology system allows our people to execute on standardized protocols across our population, which leads to better outcomes for our patients, and fewer headaches and less manual workflow for our doctors and providers,” he says.

Back-office HCIT solutions, particularly ERM, can have narrower applications to healthcare niches, potentially supporting investors’ thematic investment strategies. “That dynamic enables healthcare and technology investors to dive deeply into applicable subsectors, apply previous experience and articulate well-defined value creation plans,” says Dan Linsalata, a managing director in Harris Williams’ Healthcare & Life Sciences Group and Technology Group.

HCIT innovation hasn’t merely focused on behind-the-scenes administrative processes. Patient-facing technologies are quickly shifting from a competitive advantage to a must-have.

“Telehealth is most certainly one of the big patient-facing technologies,” says Brian Greenberg, CEO of investment bank Greenberg Advisors. “We’re seeing firms like the Amazons and Walmarts now entering the telehealth space—often through acquisition.”

Indeed, earlier this year Amazon completed its $3.9 billion acquisition of One Medical to augment its healthcare business with telehealth capabilities. Walmart, meanwhile, acquired telehealth company MeMD in 2021.

While initial patient engagement solutions tended to offer a one-size-fits-all approach, next-gen solutions like personalized, step-by-step care plans are beginning to crop up—and entice investors, according to Clark.

Herman agrees that IT organizations today are “pushing the envelope” around how to improve the customer experience with advances in digital patient communication, scheduling, bill review and call support. “Healthcare doesn’t have the best reputation for customer service,” he notes. “But that is changing.”

Herman also highlights the recent shift in the healthcare ecosystem toward value-based care, which bases provider payment on patient outcomes. HCIT solutions can facilitate that shift by improving patient experiences while limiting the impact on providers’ bottom lines and labor needs. To support that effort, LightBay portfolio company Rancho Family Medical Group, for example, implemented value-based care strategy solution provider Lumeris.

Innovation Driving M&A

As HCIT innovations improve productivity in the back office and enhance patient experiences, healthcare providers and their sponsors are driving demand for cutting-edge solutions.

Healthcare players and investors are closely watching how artificial intelligence could impact HCIT, for example, though experts say it's too soon to tell what the outcome will be. Both Greenberg and Herman acknowledge that the healthcare industry's stringent regulatory requirements can make AI adoption a challenge.

Manual workflows like repetitive data entry will likely be among the first areas impacted by AI. For more complex applications, AI will first have to prove its return on investment and accuracy to gain trust and adoption among providers, they say.

Proving its worth remains a hurdle for any HCIT solution, notes Herman, especially as economic uncertainty weighs on spending behavior. "If customers aren't as confident around what the future may hold, they're going to be less inclined to make a multiyear commitment to an outsourced tech-enabled solution or technology vendor," he says.

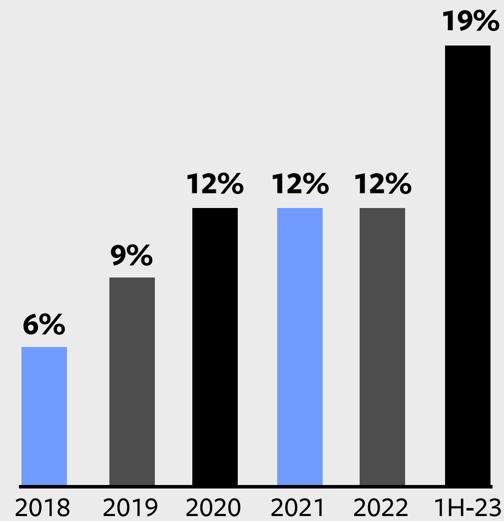
Harris Williams' Linsalata adds that some providers lack the expertise to use software tools to their full potential. In the meantime, he says, HCIT consultants are gaining a stronger footing in the market, adding another pool of potential investment targets. This trend was reflected in the recent acquisition of eCloud Managed Solutions, which guides healthcare clients through cloud migration, by HCIT staffing and consulting company Optimum Healthcare IT, a portfolio company of PE firm Achieve Partners.

With evidence of stabilizing valuations and a comeback in deal volume, financial and strategic investors alike are expected to add more HCIT targets to their deal pipelines.

"Healthcare IT solves problems that are not going away," says Linsalata. "As healthcare delivery, reimbursement and treatment models evolve and become more complex, there will be a persistent need for more and better technology and analytics to support that evolution." **//**

CAROLYN VALLEJO is *Middle Market Growth*'s digital editor.

Percentage of HCIT M&A Transactions Involving AI Companies



Data source: Greenberg Advisors' M&A Update: First Half - 2023 report.

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DAN LINSALATA | *Managing Director, Healthcare & Life Sciences Group and Technology Group, Harris Williams*

Key Takeaways

CATCH UP QUICKLY: From transformative technology to the research areas fueling outsourced pharma services, here are a few highlights from *Middle Market Growth*'s healthcare report.

Feeding Frenzy

Experts expect M&A to reshape the battered healthcare landscape, as large companies with strong balance sheets that have weathered the storm of the past several years swoop in to buy smaller healthcare businesses. "We are expecting a lot of M&A activity to happen in the middle market," says Ross Nelson, principal and national healthcare strategy leader at KPMG. ***"Navigating the Turbulent Waters of Healthcare Mergers and Acquisitions," p. 6.***

Tech Support

Healthcare's complexity and inefficiency make it a fertile industry for revenue cycle management and electronic records management technology. Meanwhile, labor challenges related to medical claims coding and processing strengthen the appeal of these solutions even further, says James Clark, managing director in the Healthcare & Life Sciences Group of investment bank Harris Williams. ***"Healthcare Evolves to Embrace Next-Gen Tech," p 24.***

On Trial

Private equity investors continue to show strong interest in businesses that offer clinical trial site management services. James Castro, senior managing director at B. Riley Financial, points to continued spending on studies related to the central nervous system and early cancer detection, "which means drug developers will need more support from the biotech and outsourced pharma communities," he says. ***"Investors Bet on High-Growth Pharma Companies," p. 20***.

Time's Up

A federal law from the mid-2000s changed reimbursement rates for cardiologists, which in turn prompted many to leave private practice to join a hospital system. But as their hospital contracts expire and they reconsider their future employment, some cardiologists may look to join an independent practice or start their own—and private equity is ready and willing to partner with them. ***"Healthcare Services Sector Gains Strength," p. 16.***